Options unlimited

Michael Lansdell looks at the arguments against incorporation and covers the dilemmas that could lay ahead

Since the GDC amended its regulations to allow dentists to trade as limited companies, a continuing debate, much of it ill-informed, has been taking place among dental professionals who are unsure how to proceed. When it comes to making radical change, inertia is part of the human condition, and undoubtedly some effort is required to covert a sole trader practice to a limited company. Existing business arrangements, which may include loans, leases, staff contracts, hire-purchase agreements and service contracts, need to be changed into the name of the new company. The new company must also have its own bank account and practice work within the NHS will need to inform their PCT of their intentions. One natural side effect is the opportunity to review existing contracts and update them where necessary.

Fortunately, these formalities are a one-off and in most cases the practice manager can carry out most of the administration: All changes can be carried out without major disruption in the practice, and without compromising the continuity of patient care. The immediate incentive is added value – increasingly, limited company practices offered for sale are attracting a premium of up to 15 per cent, in particular those with PCT contracts in the name of the limited company with no restrictions.

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Capital Gains Tax
Selling the practice to a limited company, as part of incorporating, will mean paying Capital Gains Tax (CGT), since the value of the practice at the time of incorporating, and that of the goodwill in particular, is certain to be greater than the original purchase price.

Current CGT rates are 10 per cent of the capital gain on the first £1,000,000, and 18 per cent thereafter. However, the CGT paid can be recovered – and profited upon – by tax savings over the years following the incorporation.

For legal and tax purposes, a business owned by a sole trader has no separate identity and is deemed to form part of the individual’s personal affairs. Establishing a limited company brings into being an additional
legal entity and taxpayer with its own legal obligations and tax liabilities. Although this may have little day-to-day impact on the dentist, it does require additional accounting procedures, which will be reflected in increased professional fees.

These additional costs need to be seen in the context of the overall tax savings and other benefits of incorporating. Before committing to incorporation, a detailed assessment should be completed, comparing the raised running costs of a limited company with the projected tax savings in order to inform the final decision.

Tax allowances for motor vehicles owned and driven by sole traders are markedly different to those registered to a limited company, and depending on the vehicle's cost and CO2 emissions it may be preferable for ownership to be retained by the individual. Although this is a relatively minor matter in the overall financial and fiscal context of incorporating, it should still be taken into account.

A complicated business

Many dentists are wary of incorporating as they fear complications or tax disadvantages should they ever wish to sell their practice(s). There is one transfer scenario where such complications could occur.

If a purchaser takes over the shares in the company that owns the practice, there is very little difference from a tax point of view for the vendor between him/her being as a sole trader, or him/her being the owner of the shares in a limited company.

However, the vendor’s tax position will be less favourable if the purchaser wishes to buy the business (the practice) out of the limited company but not the company itself.

This is best illustrated by a hypothetical example.

Bob is a dentist who established his practice from scratch and after 10 years decides to incorporate; his practice goodwill is valued at £400,000, and this is the price paid by the limited company.

Several years later, Sue, another dentist, agrees to buy Bob’s practice and pay £600,000 for the goodwill.

If Sue buys Bob’s shares in the limited company, Bob becomes liable for Capital Gains Tax on the £600,000 at the CGT rates applicable at that time. (Currently, 10% on the first £1,000,000 per taxpayer per lifetime and 18% thereafter.)

However, if Sue buys the goodwill out of the limited company but does not take over Bob’s shares, it’s the company that makes a capital gain of £200,000 on the £400,000 price it paid Bob when it bought the practice. Limited companies pay Corporation Tax on all their profits, including capital gains, and so the company must now pay Corporation Tax on the £200,000; depending on any other profits it may have made, it will be levied at between 21% and 24% (2009/2010 rates).

In order for Bob to then pay the 10% or 18% personal CGT rate on the gain that he receives after the corporation tax has been paid, the company will need to be wound up. However, this potential tax chancing dentist in maintaining the trading continuity afforded by taking over the company’s contracts and any other business arrangements which are already in place, including any PCT contract i.e. by purchasing the shares in the limited company.

Potential purchasers are sometimes wary that undisclosed company liabilities may surface post transfer, but these can be resolved by warranties and the sale agreement supported by the setting up of an escrow account with a proportion of the purchase price held there for an agreed period after sale.

There are various and varied facets to incorporation, and it may not suit the circumstances of every principal or every practice, so it’s vital to take into account with a proportion of the purchase price held there for an agreed period after sale.

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